

The Service Occupation Tax is a tax imposed upon servicemen engaged in the business of making sales of service in this State, based upon the tangible personal property transferred incident to sales of service. See, 35 ILCS 115/3 (This is a GIL).

March 7, 2003

Dear Xxxxx:

This letter is in response to your letter dated September 16, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be accessed at the Department's Website at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

RULING REQUESTED:

We are requesting a Letter Ruling from the Department of Revenue on the taxability of the transactions outlined below. Depending on your Ruling, the potential impact on Company X's current operations and billing methods could be extreme; therefore, we respectfully request an expedited response. Company X is not in an ongoing dispute with the state of Illinois regarding the issues stated below. Currently, there is not an active audit, protest, or appeal involving Company X and the state of Illinois.

Due to the complexity of the transaction and related statutes, Company X, based on the following scenario, is requesting a Ruling to determine what portion of the retail selling price an subsequent shipping and handling charges will be subject to sales and/or use tax and at what point in time tax should be remitted.

BACKGROUND:

Company X, a licensed out-of-state seller, is engaged in the solicitation of sales of tangible personal property to customers located within the state of Illinois. These profit and not-for-profit customers may have locations or customers outside the state of Illinois as well.

Company X, a C Corporation organized and located outside of Illinois, was incorporated in 1965. The Company's business activity within Illinois consists of solicitation of sales for printed clinical research materials to for-profit and not-for-profit pharmaceutical entities (end users) to be utilized in drug studies, clinical trials and other informational uses. The clinical research materials can be delivered in the form of loose-leaf pages, folders, threefold pamphlets etc. Company X's customers provide text information and a description of the required layout or format for the clinical research materials to be

printed. Company X subsequently provides the composition, printing service including supplies, binding if necessary and any required packaging.

Customer orders are in virtually all instances printed in one lot instead of on an as needed basis. Upon completing the order, the customer is billed for the entire contract price associated with the production run regardless of whether the product is immediately shipped or subsequently stored in Company X's warehouse. Due to the nature of clinical research and drug studies, the purchaser is not able to immediately determine where or when the product stored in Company X's warehouse may be required to be shipped.

Any customer order shipped in one lot (no storage) will be shipped Free On Board (F.O.B.) Company X's loading dock. Any order where the product is not immediately shipped will be stored in Company X's climate controlled warehouse outside of Illinois at no additional charge. During the period of storage, Company X will insure the product against damage or loss. However, the product stored is not inventory on the books of Company X since legal title has passed to the customer in a state outside of Illinois. The period of storage may range from several days to several years with shipment occurring at the direction of the purchaser. Releases from storage may be in increments or the entire stock at once. Company X's distribution policy for stored products requires a formal written release from the customer with the handling fees and the shipping charges separately itemized and billed for any product shipped. The customer will only be charged for shipping and/or handling on subsequent shipments of product. Shipments are via common carrier as arranged by Company X. Any products in the warehouse, without activity for an extended period of time (several years), may be destroyed upon confirmation to do so from the customer.

The following scenarios are intended to illustrate a common type of sales transaction encountered by Company X. The percentages are intended for illustrative purposes only and may vary depending on the transaction.

Scenario 1

Company X manufactures a set amount of clinical research study materials for Customer A, an Illinois based taxpayer. Customer A is billed for the entire contract price at the time the printing is complete. Ten percent of the product is immediately shipped to Company A at their Illinois location with ninety percent stored at Company X's warehouse located outside the state of Illinois, at Company A's request. The remaining ninety percent will be shipped over time at Company A's direction F.O.B., Company X's loading dock. The period before the product is shipped could span from a few days to several years. The shipment of the remaining product often includes delivery to states other than Illinois at Company A's direction. Freight and handling are billed to the customer separately upon shipment; however, the customer is not billed for the subsequent releases of product as the customer was billed for the full contract price at the time the printing was completed. During the period of time the product is stored, Company X will insure the product.

ISSUES:

Issue #1

Is the seller required to collect and remit Illinois sales tax on the initial shipment of products sold to the Illinois end user?

Issue #2

Is the seller required to collect and remit sales tax, or is it the customer's responsibility to remit use tax, on the subsequent shipments of research materials, as it is not known at the initial time of sale when, where, or to whom the research materials will be delivered?

Issue #3

Is the seller required to collect and remit Illinois sales tax on the shipping and handling charges for any of the shipments, the initial shipment or subsequent shipments which may occur up to several years after the initial sales transaction?

DISCUSSION OF LAW:

Issue #1

Illinois Statute § 35 ILCS 120/2 imposes the Retailer's Occupation Tax (ROT) on persons engaged in the business of selling tangible personal property at retail. A retailer is defined in Illinois Law § 35 ILCS 105/2 to be a person who holds himself out as making retail sales or who habitually makes retail sales. Illinois Regulation 86 Ill. Adm. Code 130.201 defines a sale at retail to be any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale. The tax is measured by the gross receipts received from the sale (86 Ill. Adm. Code 130.101). Illinois Statute § 35 ILCS 105/3 imposes a Use Tax (UT) that complements the ROT on the privilege of using in Illinois tangible personal property purchased anywhere at retail from a retailer.

The legal incidence of the ROT falls on the sellers, who generally reimburses themselves by collecting UT from its customer. A purchaser is liable for the UT and is required to pay UT to the seller or directly to the state (Illinois Regulation §86 Ill. Adm. Code 150.130). The retailer must remit the UT that he collects to the Department. However, since the ROT and UT work together in a complementary manner, the retailer may reduce the amount of UT he must remit by the amount of ROT (if any) that he is required to and does pay to the Department with respect to the same sale.

Since the clinical material is sold to not for profit pharmaceutical entities to be utilized in drug studies, clinical trials and other informational uses, examination was made regarding the taxability of nonprofit organizations. *Illinois Adm Code 130.2005 Persons Engaged in Nonprofit Service enterprises and in Similar Enterprises Operated as Business, and Suppliers of Such Persons* allows for an exemption from the ROT for sales to nonprofit institutions, associations and organizations if the material is purchased for resale or if the material although consumed by the nonprofit organization is exclusively charitable. An organization that is exclusively charitable is organized and conducted on a not-for-profit basis, with no personal profit inuring to anyone including the distribution of director's fees. (IL Adm Code 130.2005(h)) An example of a non-profit organization that would be exempt from ROT includes nonprofit corporations, societies, associations, foundations and institutions organized and operated exclusively for the

purpose of conducting scientific research of a character that would be beneficial to the public. (IL Adm Code 130.2005(k))

Illinois law provides that the initial sale by Company X of printed clinical research materials to customers in the state of Illinois would be subject to ROT upon the initial retail sale and delivery to the Illinois customer provided the Illinois customer is not a non-profit organization as outlined above. Company X would be liable for ROT, but would be able to collect UT to reimburse them. Company X would be required to collect the UT and remit the tax to the state. The amount of tax due would be computed on the value of the initial shipment into the state of Illinois. Illinois law does not subject the property stored outside of Illinois, to Illinois taxation at the time of initial sale.

Issue #2

As previously cited, Illinois Statute § 35 ILCS 120/2 imposes the Retailer's Occupation Tax (ROT) on persons engaged in the business of selling tangible personal property at retail. The legal incidence of the ROT falls on the sellers, who generally reimburse themselves by collecting UT from its customer. If the retailer fails to collect the tax from the purchaser, the Department is not precluded from collecting the tax directly from the purchaser. A purchaser is liable for the UT and is required to pay UT to the seller or directly to the state (Illinois Regulation 86 Ill. Adm. Code 150.130).

Illinois law requires that the any subsequent shipment by Company X of printed clinical research materials to customers in the state of Illinois would be subject to UT upon delivery and subsequent consumption by the Illinois customer. The consumer would be required to remit UT to the state. The amount of UT due would be on the value of the shipment into the state of Illinois. ROT is not due in this case, as there are no gross receipts associated with the subsequent shipment, as the price was paid in full upon the initial order.

Issue #3

Pursuant to Illinois Regulation § 86 Ill. Adm. Code 130.415, if the seller and the buyer agree upon the transportation or delivery charges (shipping and handling) separately from the selling price of the tangible personal property which is sold, then the cost of the transportation or delivery service is not a part of the 'selling price' of the tangible personal property which is sold, but instead is a service charge, separately contracted for, and need not be included in the figure upon which the seller computes his Retailers' Occupation Tax (ROT) liability. Delivery charges are deemed to be agreed upon separately from the selling price of the tangible personal property being sold so long as the seller requires a separate charge for delivery and so long as the charges designated as transportation or delivery or shipping and handling are actually reflective of the costs of such shipping, transportation, or delivery.

Shipping charges separately stated on the invoice and separately contracted for by Company X on deliveries into Illinois are not subject to taxation by the state so long as the shipping and handling cost are reflective of such costs. To the extent that such charges exceed the costs of shipping, transportation or delivery, the charges are subject to tax.

Scenario 2

Company X manufactures a set amount of clinical research study materials for Customer A, a non-Illinois based taxpayer. Customer A is billed for the entire contract price at the time the printing is complete. Ten percent of the product is immediately shipped to Customer A at their non-Illinois location with ninety percent stored at Company X's warehouse located outside the state of Illinois, at Company A's request. The remaining ninety percent will be shipped over time at Customer A's direction F.O.B., Company X's loading dock. The length of time between the initial shipment and subsequent shipments could span from a few days to several years. The shipment of the remaining product often includes delivery to locations in Illinois and states other than Illinois at Customer A's direction. Freight and handling are billed to the customer separately upon shipment; however, the customer is not billed for the subsequent releases of product as the customer was billed for the full contract price at the time the printing was completed. During the period of time the product is stored, Company X will insure the product.

ISSUE:

Issue #1

Is the seller required to collect and remit Illinois sales tax, or is it the customer's responsibility to remit Illinois use tax, on the subsequent shipments of research materials to a customer in Illinois?

DISCUSSION OF LAW:

Issue #1

Illinois Statute § 35 ILCS 120/2 imposes the Retailer's Occupation Tax (ROT) on persons engaged in the business of selling tangible personal property at retail. As in Scenario #1, Company X is the retailer. The difference between the two scenarios is the location of the customer. In Scenario #1, the customer was located in Illinois. In Scenario #2, the customer is located outside Illinois, however, directs the retailer to ship the clinical research material into Illinois. The material will be consumed by an Illinois based operation of Customer A or a non-profit entity working on behalf of Customer A. Does the legal incidence of the ROT, remain with Company X or is it transferred to Customer A as UT?

The legal incidence of the ROT falls on the sellers, who generally reimburses themselves by collecting UT from its customer. A purchaser is liable for the UT and is required to pay UT to the seller or directly to the state (Illinois Regulation 86 Ill. Adm. Code 150.130). The retailer must remit the UT that he collects to the Department. However, since the ROT and UT work together in a complementary manner, the retailer may reduce the amount of UT he must remit by the amount of ROT (if any) that he is required to and does pay to the Department with respect to the same sale. However, the retailer's failure to collect the tax from the purchaser does not prevent the Department from collecting the tax directly from the purchaser whether the retailer's liability to remit the tax is to remit it in the form of ROT or in the form of UT. If the user purchases the tangible personal property at retail from a retailer, but does not pay the UT to such retailer, the purchaser shall pay the UT directly to the Department.

Illinois law establishes that the subsequent shipment by Company X of printed clinical research materials to customers in the state of Illinois would be subject to UT upon delivery and subsequent consumption by the Illinois customer. The consumer would be required to remit UT to the state. The amount of UT due would be on the value of the shipment into the state of Illinois. ROT is not due in this case, as there are no gross receipts associated with the subsequent shipment, as the price was paid in full upon the initial order.

We contend that any subsequent shipments of clinical research materials owned by a non-Illinois customer into Illinois after the initial shipment would not be subject to ROT as there are no gross receipts associated with the subsequent shipments. However, the shipments of the clinical research materials occurring after the initial shipment would be subject to UT and the responsibility of the purchaser.

Closing

Should your conclusion differ substantially from the one reached herein, we respectfully request you contact PERSON for further discussion prior to issuance of a Ruling.

Under penalties or perjury, we declare that we have examined this request and to the best of our knowledge and belief, the facts presented in support of this Ruling Request are true, correct, and complete.

DEPARTMENT'S RESPONSE

When Company X produces and sells custom printed clinical research materials, it appears to be engaged in special order printing. Under Illinois tax law, the transfer of special order printing materials is a service transaction that may result in either Service Occupation Tax or Use Tax liability for the special order printer. For your general information see 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax. A serviceman's liability may be calculated in one of four ways: 1. separately stated selling price of tangible personal property transferred incident to service; 2. 50% of the serviceman's entire bill; 3. Service Occupation Tax on the serviceman's cost price if he is a registered de minimis serviceman; or, 4. Use Tax on the serviceman's cost price if he is a de minimis serviceman not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

In regards to the first three methods, service customers incur a corresponding Service Use Tax liability which is required to be collected by the serviceman. In the fourth method listed above, a Use Tax liability is incurred by the serviceman, and no liability is incurred by his service customer. For this reason, this type of serviceman has no legal authority to collect a "tax" from his service customer.

Based on the limited information you have provided, we do not believe that your client will incur liability under the Service Occupation Tax, since it does not appear to make sales of service in Illinois.

It is our understanding that many, if not most, special order printers calculate their tax liability utilizing the fourth base described above. In other words, these special order printers remit Use Tax on the cost price of the tangible personal property transferred incident to their sales of service. These servicemen are considered the end users of the tangible personal property transferred to service

customers, and therefore have no legal authority to collect tax from their customers. However, to the extent that these servicemen make sales to exempt entities that have been issued exemption numbers issued by the Department, our regulations authorize a “flow-through” of the purchaser’s exempt status. See Section 140.108(a)(2)(A) for further information.

If your client was a “de minimis” serviceman (See Section 140.108) and was not otherwise required to be registered as a retailer under Section 2a of the Retailers’ Occupation Tax, it could handle its liability as provided in Section 2 (g) of the Service Occupation Tax. Section 2 (g) states that “the purchase of such tangible personal property [i.e., the tangible personal property the serviceman transfers to the service customer] by the serviceman shall be subject to tax under the Retailers’ Occupation Tax Act and the Use Tax Act.” See, 35 ILCS 115/2 (g). Your letter does not contain sufficient information to make a specific ruling (which we also cannot do in the context of a General Information Letter), but we think it is doubtful, given the limited information that you have provided, that your client would incur any Use Tax liability if it were eligible to elect status as a “de minimis” serviceman under the fourth method explained above. At any rate, your client would clearly not be authorized to collect an Illinois tax from its customers if it utilized this fourth method. You may wish to review the provisions of another letter ruling issued by the Department, ST-01-0026-PLR, for information regarding transactions involving application of the fourth method listed above to out-of-state servicemen.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department’s Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

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